Newfoundland
Labrador

Government of Newfoundland and Labrador
Department of Finance

Newfoundland and Labrador Government Sinking Fund

Annual Performance Report 2015/16

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BOARD OF TRUSTEES
NEWFOUNDLAND AND LABRADOR CONSOLIDATED SINKING FUNDS

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION SINKING FUND
P.O. BOX 8700
ST. JOHN'S, NL
A1B 4J6

DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING

September 22, 2016

Message from the Board

I am pleased to present the Annual Performance Report for the Newfoundland and Labrador Government Sinking Fund for the 2015-16 fiscal year.

The Newfoundland and Labrador Government Sinking Fund administers the sinking funds established by the Province of Newfoundland and Labrador for the repayment of the Province's debenture debt. The effective investment and control of these funds is consistent with the Department's responsibilities with respect to stewardship of public money and management of the funded debt.

This performance report provides an overview of the Newfoundland and Labrador Government Sinking Fund and identifies key issues and results for the Board of Trustees during the fiscal year 2015-16. The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $57.6 million during 2015-16, which included a foreign exchange gain of $2.3 million, resulting from an increase in the value of the U.S. dollar. This represents a 4.73% return on the Sinking Fund Equity.

The Board of Trustees is accountable for the preparation of this report and for the results reported therein.

Donna Brewer
Chairperson

1.0 Overview

The Newfoundland and Labrador Government Sinking Fund was created pursuant to the *Financial Administration Act* to consolidate and administer sinking funds established for the repayment of the Province's debenture debt. The Province has established sinking funds for most of its long-term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees of the Newfoundland and Labrador Consolidated Sinking Funds, appointed by the Lieutenant Governor in Council to manage and control the day to day operation of the sinking funds. As at 31 March 2016, the Board of Trustees consists of the incumbents in five senior public service positions with the Department of Finance as follows:

Donna Brewer	Deputy Minister
Ann Marie Miller	Comptroller General
Craig Martin	Assistant Deputy Minister Taxation and Fiscal Policy
Paul Myrden	Director, Debt Management
Linda Howell	Manager of Debt Servicing & Financial Risk

The Newfoundland and Labrador Government Sinking Fund operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

2.0 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the Newfoundland and Labrador Government Sinking Fund and the sinking funds of certain crown corporations where the Province has guaranteed the related debt (i.e. Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the *Financial Administration Act,* primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, the government of a province of Canada, or a chartered bank, with the goal of earning the maximum return from investment of the portfolio while ensuring security of the funds.

3.0 Primary Clients and Stakeholders

The Board's primary responsibility is to the bondholders of the Province's debt and to the taxpayers of the Province, in ensuring Provincial compliance with the terms and conditions of its debenture debt and prudent management of the Fund's assets for future application against the Province's outstanding debt.

4.0 Sources of Funding

For debenture issues which have sinking fund requirements, the Province makes the required sinking fund contributions to the operating bank account managed by the Board of Trustees. In 2015-16, these sinking fund payments amounted to $46,853,000. Sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Province for reimbursement of these expenses on a cost-recovery basis.

5.0 Financial Statements

The Newfoundland and Labrador Government Sinking Fund earned a net income of approximately $57.6 million during 2015-16, after a foreign exchange gain of $2.3 million, resulting from an increase in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that the U.S. assets are converted to Canadian dollars. Special purpose financial statements for the year ending March 31, 2016 are included in this report.

6.0 2014-17 Activity Plan Update

In accordance with the Board's mandate the following objective was identified for the 2015-16 fiscal year, which focuses on the primary activities of establishing investment policy; and the investment and monitoring of funds.

Objective: By March 31, 2016 Board of Trustees will have continued with the prudent investment of the assets of the Fund.

Measure: Board's prudent investment of the Fund's assets

Indicators: The assets of the Fund prudently invested in accordance with the *Financial Administration Act* as evidenced by the completion of periodic reviews of reports to the Board.

Results: The Board completed a review of an annual report to the Board which, in addition to financial results of the Fund, highlighted the investing activity of the Fund, ensuring that the assets of the Fund were prudently invested in accordance with the *Financial Administration Act* and with the Board's mandate.

Pursuant to the 2014-17 Activity Plan of the Board, the following objective is identified for the 2016-17 fiscal year:

Objective: By March 31, 2017 Board of Trustees will have continued with the prudent investment of the assets of the Fund.

Measure: Board's prudent investment of the Fund's assets

Indicators: The assets of the Fund prudently invested in accordance with the *Financial Administration Act* as evidenced by the completion of periodic reviews of reports to the Board.

7.0 Opportunities and Challenges

The unpredictable nature of the investment market will continue to challenge the Board of Trustees to ensure that its investment strategy maximizes the rate of return earned on its investment portfolio while at the same time, protects the security of the sinking funds. A slow global economic recovery with a low interest rate environment continues to restrict the earning potential of the investment portfolio.

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

FINANCIAL STATEMENTS

MARCH 31, 2016

AUDITOR GENERAL
of Newfoundland and Labrador

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of the
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

Report on the Financial Statements

I have audited the accompanying financial statements of the Newfoundland and Labrador Government Sinking Fund which comprise the balance sheet as at March 31, 2016, and the statements of statutory contributions, retained earnings, revenues and expenses, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting policies described in Note 1 to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the judgment of the auditor, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

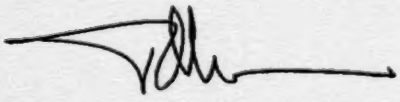
Independent Auditor's Report (cont.)

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newfoundland and Labrador Government Sinking Fund as at March 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with the accounting policies described in Note 1 to these financial statements.

Basis of Accounting and Restriction on Use

Without modifying my opinion, I draw attention to Note 1 of the financial statements which describes the basis of accounting. These financial statements are solely for the information of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador to meet their information needs under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds. As a result, the financial statements may not be suitable for another purpose. My report is intended solely for the use of the Newfoundland and Labrador Sinking Fund and the Government of Newfoundland and Labrador and should not be used by anyone other than the specified users.



TERRY PADDON, CPA, CA
Auditor General

September 7, 2016
St. John's, Newfoundland and Labrador

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND

BALANCE SHEET

As at March 31

	2016 (000's)	2015 (000's)
ASSETS		
Current		
Cash	$ 56,979	$ 55,798
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	10,576	8,978
Other	5,600	5,483
	73,155	70,259
Investments, at amortized cost (Schedule)		
Cost	1,086,985	980,845
Accumulated amortization of discounts and premiums	59,287	53,964
	1,146,272	1,034,809
	$ 1,219,427	$ 1,105,068
LIABILITIES AND SINKING FUND EQUITY		
Current		
Accounts payable and accrued liabilities	$ 10	$ 10
Due to Province of Newfoundland and Labrador	4	99
	14	109
Sinking fund equity		
Accumulated statutory contributions	682,266	629,996
Retained earnings	537,147	474,963
	1,219,413	1,104,959
	$ 1,219,427	$ 1,105,068

See accompanying notes

Signed on behalf of the Board:

Chairperson and Trustee

Trustee

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS
For the Year Ended March 31

	2016	2015
	(000's)	(000's)
Balance, beginning of year	**$ 629,996**	$ 611,358
Add: receipts for the year	**46,853**	46,620
Foreign currency translation adjustment (Note 2)	**5,417**	26,018
	682,266	683,996
Statutory contributions applicable to matured/redeemed debentures	**-**	(54,000)
Balance, end of year	**$ 682,266**	$ 629,996

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS
For the Year Ended March 31

	2016 (000's)	2015 (000's)
Balance, beginning of year	**$ 474,963**	$ 473,680
Net income for the year	**57,645**	62,372
Foreign currency translation adjustment (Note 2)	**4,539**	25,678
	537,147	561,730
Retained earnings applicable to matured/redeemed debentures	**-**	(86,767)
Balance, end of year	**$ 537,147**	$ 474,963

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended March 31

	2016 (000's)	2015 (000's)
REVENUES		
Interest income		
Debentures	$ 48,795	$ 42,341
Other	402	862
	49,197	43,203
Foreign currency translation gains (Note 2)	2,281	9,229
Amortization of discounts and premiums	6,447	10,195
	57,925	62,627
EXPENSES		
Salaries and benefits	147	140
General	133	115
	280	255
Net income	$ 57,645	$ 62,372

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS
For the Year Ended March 31

	2016	2015
	(000's)	(000's)
Cash flows from operating activities		
Net income	$ 57,645	$ 62,372
Adjustment for non-cash items		
Amortization of discounts and premiums	(6,447)	(10,195)
Foreign currency translation gains (Note 2)	(2,281)	(9,229)
	48,917	42,948
Change in non-cash working capital	(1,810)	(931)
	47,107	42,017
Cash flows from financing activities		
Statutory contributions	46,853	46,620
Cash flows used in investing activities		
Purchase of investments	(114,883)	(69,676)
Proceeds from redemption and sale of investments	22,016	100,918
Payments to Province upon maturing debentures	-	(140,767)
	(92,867)	(109,525)
Net increase (decrease) in cash	1,093	(20,888)
Effect of foreign currency translation adjustment (Note 2)	88	5,914
Cash, beginning of year	55,798	70,772
Cash, end of year	$ 56,979	$ 55,798

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS
March 31

	2016		2015	
	Face Value or Par (000's)	**Amortized Cost (000's)**	Face Value or Par (000's)	Amortized Cost (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	**$ 143,329**	**$ 165,199**	$ 91,376	$ 98,218
Newfoundland and Labrador Municipal Financing Corporation	**-**	**-**	16	16
Newfoundland and Labrador Hydro	**30,248**	**34,182**	30,248	34,482
Health Care Corporation (Eastern Health)	**17,500**	**25,348**	17,500	25,673
Coupons and residuals	**220,682**	**132,443**	202,268	117,406
	411,759	**357,172**	341,408	275,795
Other coupons and residuals	**322,317**	**183,805**	321,333	173,675
Other securities	**91,017**	**104,544**	98,544	109,084
	825,093	**645,521**	761,285	558,554
U.S.				
Province of Newfoundland and Labrador - guaranteed	**175,439**	**187,812**	169,712	183,847
Other securities	**255,808**	**286,635**	235,513	267,895
Coupons	**27,883**	**22,800**	27,194	21,241
Residuals	**4,071**	**3,504**	3,971	3,272
	463,201	**500,751**	436,390	476,255
Total investments	**$ 1,288,294**	**$ 1,146,272**	$ 1,197,675	$ 1,034,809

See accompanying notes

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act.* All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

The Newfoundland and Labrador Sinking Fund is not subject to Provincial or Federal income taxes.

1. Basis of accounting

These special purpose financial statements have been prepared by the Newfoundland and Labrador Government Sinking Fund in accordance with the summary of significant accounting policies set out below to meet the information needs of the Newfoundland and Labrador Government Sinking Fund and the Government of Newfoundland and Labrador under Section 39 of the *Financial Administration Act* and under the various debentures which require the establishment of sinking funds.

Summary of significant accounting policies

These financial statements have been prepared on the accrual basis of accounting. Outlined below are the significant policies followed.

(a) Cash

Cash includes balances with banks.

(b) Investment transactions

(i) Purchases: Investments are initially recorded at cost.

(ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.

(iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.

(iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

1. Basis of accounting (cont.)

Summary of significant accounting policies (cont.)

(c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided:

(i) General

A sinking fund is created pursuant to the provisions of a debenture issue in order to provide funds to be used for redemption at debenture maturity. Statutory sinking fund contributions are invested in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The accumulated amount of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At the maturity of a debenture issue, accumulated statutory contributions are reduced by the total amount of statutory contributions received over the life of the debenture issue. Retained earnings are reduced by the excess of the Sinking Fund Value over statutory contributions received related to the debenture issue.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the particular debenture issue being redeemed held in the Fund's investments. If the Sinking Fund Value of the issue is less than the total face value, the difference is paid into the redemption bank account by the Province.

(d) Province of Newfoundland and Labrador debentures held by the Sinking Fund are cancelled upon the related sinking fund becoming fully funded. This occurs when the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue. The Sinking Fund will return to the Province, for cancellation, any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity.

(e) Interest income

Interest income is recorded on an accrual basis.

1. **Basis of accounting (cont.)**

Summary of significant accounting policies (cont.)

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

(i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and

(ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. **Effect of foreign currency translation**

At March 31, 2016, the Fund held $1,146,272,000 (2015 - $1,034,809,000) in investments. These investments include $500,751,000 denominated in U.S. currency (2015 - $476,255,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

In 2016, the translation of assets denominated in U.S. currency at year end resulted in a net foreign exchange gain due to an increase in the value of the U.S. dollar. In 2015, the translation of assets denominated in U.S. currency at year end resulted in a net foreign exchange gain due to an increase in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time the assets denominated in U.S. currency should ever actually be converted to Canadian dollars. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

2. Effect of foreign currency translation (cont.)

	2016 (000's)	2015 (000's)
The effect of the translation is as follows:		
Statutory contributions have increased by	$ 5,417	$ 26,018
Retained earnings have increased by	4,539	25,678
Net income increased by	2,281	9,229
Total impact of foreign currency translation	$ 12,237	$ 60,925
The effect of this amount on the Fund assets is as follows:		
Investments have increased by	$ 12,149	$ 55,011
Cash has increased by	88	5,914
	$ 12,237	$ 60,925

The increase of $88,000 (2015 - increase of $5,914,000) is reflected in the Statement of Cash Flows because of its impact on the Fund's cash flow position. However, the other transactions did not have an impact on the Fund's cash flow position and are, therefore, not reflected in the Statement of Cash Flows.

3. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund holds long-term investments which have an amortized cost of $1,146,272,000 (2015 - $1,034,809,000). The face value of these investments is $1,288,294,000 (2015 - $1,197,675,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no significant market risk associated with these investments.